EDFUND

Financial Statements

September 30, 2005 and 2004

(With Independent Auditors' Report Thereon)

EDFUND

Table of Contents

KPMG LLP
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Independent Auditors' Report

The Board of Directors
EDFUND
Rancho Cordova, California:

We have audited the accompanying basic financial statements of EDFUND, a component unit of the California Student Aid Commission, as of and for the years ended September 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of EDFUND's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of EDFUND's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of EDFUND as of September 30, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis on pages 2 through 5 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

March 24, 2006

This section of the EDFUND financial statements present management's discussion and analysis (MD&A) of its financial performance during the fiscal years ended September 30, 2005 and 2004. The information contained in this MD&A should be read in conjunction with the basic financial statements following this section.

Financial Highlights

- In 2004-05, EDFUND administered the guarantee for over $6.5 billion in new nonconsolidation student loans to borrowers, serving 1,440 colleges and universities. This annual volume represents a 15 percent increase compared to the $5.7 billion in nonconsolidation loans guaranteed in 2003-04, serving 1,301 colleges and universities.
- In 2004-05, total loan volume, including consolidation loans, equaled $7.8 billion, and represents an increase of 10 percent compared to 2003-04. However, consolidation loan volume decreased 11 percent, from $1.4 billion in 2003-04 to $1.2 billion in 2004-05.
- Claims, in the amount of $515 million, were paid to loan holders on defaulted loans in 2004-05, a 35 percent increase compared to the $381 million paid in 2003-04.
- Collections recoveries from defaulted loans for 2004-05 totaled $387 million, a 14 percent improvement from the $340 million collected during 2003-04.
- EDFUND contributed almost $1 million in grants to 14 academic institutions in fiscal year 2004-05 as part of the EDSHARE program. However, this is a 71 percent decrease compared to the $3 million funded in 2003-04 to 27 institutions. These grants were made in support of default prevention and borrower education initiatives developed at these schools.
- Total net assets increased by $616,093, to $27.5 million, in 2004-05 due to interest income earned on working capital.

Overview of Financial Statements

This report consists of four parts: *The Independent Auditors' Report*, *Management's Discussion and Analysis (this section)*, *Basic Financial Statements* (Balance Sheets, Statements of Revenues, Expenses, and Changes in Net Assets, and Statements of Cash Flows), and the *Notes to the Financial Statements*, which explain in further detail information contained in the basic financial statements.

EDFUND, a nonprofit public benefit corporation, was created on January 2, 1997, as an auxiliary organization of the California Student Aid Commission (Commission) pursuant to Section 69522(a) of the California Education Code. The creation of EDFUND was authorized by state legislation that empowered the Commission to establish a nonprofit auxiliary to carry out all activities associated with its participation in the Federal Family Education Loan (FFEL) Program. EDFUND is a proprietary component unit of the Commission, and operates under terms and conditions set forth in an annual operating agreement between the two organizations.

In administering the loan program on behalf of the Commission, EDFUND tracks cash activity related to lender claim payments and subsequent collection of defaulted loans. In addition to this activity, EDFUND's bank accounts are also used to deposit funds associated with administrative fees paid by the United States Education Department (ED). These cash transactions are verified, recorded, and transferred to or reimbursed from the Commission Loan Program Federal or Operating funds. As a result of this arrangement, the EDFUND balance sheets and statements of cash flows reflect substantial fluidity from one accounting period to another.

EDFUND's statements of revenues, expenses, and changes in net assets reflect expenses incurred by EDFUND on behalf of the Commission, and their subsequent reimbursement called program service fees. The nature of the operating agreement between the Commission and EDFUND calls for a full reimbursement of all such costs incurred by EDFUND. As a result, program service fees and operating expenses will represent the same amounts after a standard accounting period close. Also specified in the operating agreement is the process where EDFUND initially invests in capital asset purchases and is reimbursed by the Commission as the asset is used in the administration of the Loan Program.

Financial Analysis

Assets		**2005**	**2004**	**2003**
Cash and cash equivalents	$	53,713,454	44,129,233	55,135,929
Other assets		12,307,866	21,835,443	9,215,820
Capital assets, net of accumulated depreciation		4,231,105	2,553,390	2,965,935
Total assets	$	70,252,425	68,518,066	67,317,684
Liabilities and Net Assets				
Current liabilities	$	39,269,259	38,979,088	38,673,077
Long-term liabilities		3,500,972	2,672,877	2,012,287
Total liabilities		42,770,231	41,651,965	40,685,364
Net assets:				
Invested in capital assets		4,231,105	2,553,390	2,965,935
Unrestricted		23,251,089	24,312,711	23,666,385
Total net assets		27,482,194	26,866,101	26,632,320
Total liabilities and net assets	$	70,252,425	68,518,066	67,317,684

- Total assets exceeded liabilities by a total of $27.5 million at the end of the fiscal year 2004-05, compared to $26.9 million in 2003-04 and $26.6 million in 2002-03. These annual increases are attributed to the interest income earned on cash and cash equivalents. In 2004-05, approximately $4.2 million of the $27.5 million in total net assets are invested in capital assets.
- Cash and cash equivalents increased $9.6 million, or 22 percent, in 2004-05, compared to a decrease of $11 million, or 20 percent, in 2003-04. The current year increase is related to spending $7 million less on program grants and awards compared to the prior year, and an overall increase in collection recoveries. The 2003-04 decrease in cash balances resulted from EDFUND making significant vendor payments at year-end compared to 2002-03, and having a substantial receivable of $20 million due from the Commission's Operating Fund at year-end.
- Other assets decreased $9.5 million in 2004-05 compared to a $13 million increase in 2003-04. The current year decrease is attributed to a $7 million decline in program grants and awards. The 2003-04 increase was a result of having a substantial receivable due from the Commission's Operating Fund at year-end.

- Capital assets, net of accumulated depreciation, increased $1.7 million, or 66 percent, to $4.2 million in 2004-05, up from the $2.6 million total reported in 2003-04. This increase is due to several new technology-oriented asset purchases made in 2004-05. The majority of these 2004-05 acquisitions were completed at the end of the fiscal year, thus affecting the timing and amount of first year depreciation.

Following is a summary of EDFUND's statements of revenues, expenses, and changes in net assets for the years ended September 30, 2005, 2004, and 2003.

		2005	2004	2003
Operating revenues:				
Program service fees	$	96,549,469	95,415,357	89,127,696
Total operating revenues		96,549,469	95,415,357	89,127,696
Operating expenses:				
Salaries and benefits		53,513,604	50,632,118	50,785,225
Program grants and awards		6,089,300	12,906,953	2,435,848
Collection agency fees		9,705,719	7,954,069	12,588,794
Consulting and professional fees		9,022,815	6,960,450	7,256,808
Computer expense		3,296,166	3,346,357	2,823,328
Other operating expenses		14,921,865	13,615,410	13,237,693
Total operating expenses		96,549,469	95,415,357	89,127,696
Operating income		—	—	—
Nonoperating revenues (expenses):				
Grant administrative service fees		669,583	602,497	—
Interest income		616,093	233,781	274,441
Grant administrative costs		(669,583)	(602,497)	—
Total nonoperating revenues		616,093	233,781	274,441
Change in net assets		616,093	233,781	274,441
Net assets, beginning of year		26,866,101	26,632,320	26,357,879
Net assets, end of year	$	27,482,194	26,866,101	26,632,320

- EDFUND's total operating revenues increased $1.1 million, or 1 percent from 2003-04. In 2003-04, total operating revenues increased $6.3 million, or 7 percent compared to 2002-03. The increase in program service fees between fiscal years is consistent with overall increases in operating expenses since these fees are primarily reimbursements for operating expenses.

- Interest income increased by $382,000, or 164 percent, in 2004-05 compared to 2003-04. In 2003-04, interest income decreased by $41,000, or 15 percent compared to 2002-03. Annual results for both years reflect the prevailing economic conditions experienced during the year; higher interest rates in 2004-05 compared to 2003-04, and higher cash balances in EDFUND bank accounts in 2004-05.

- Total operating expenses for 2004-05 grew $1.1 million, or 1 percent, compared to 2003-04. However, certain expense lines experienced significant variances from prior year activity.
  - Salaries and benefits increased $2.8 million, or 6 percent, compared to the prior year. This increase is attributable to staff additions in client relations marketing to promote and support loan volume growth, and a substantial increase in medical and pension benefit costs.
  - Program grants and awards decreased by $6.8 million from prior year levels due to reduced spending in outreach programs, including the EDSHARE for institutions program.
  - Collection agency fees increased almost $1.8 million, or 22 percent, compared to 2003-04 and are directly related to the $47 million, or 14 percent, increase in gross collection recoveries compared to prior year.
  - Consulting and professional fees increased $2.1 million compared to 2003-04, primarily in computer consultant fees supporting new generation technology initiatives, and outsourced skip-tracing fees enhancing default prevention efforts.
  - Other operating expenses increased $1.3 million, or 10 percent, compared to the prior year. This increase is noted predominantly in facilities operations, communications, postage, travel, and prorata. These expenses, with the exception of prorata, are related to the increase in marketing staff as operating costs grow proportionately in support of achieving loan volume growth. Prorata, however, is an uncontrollable expense imposed by the state to cover central administrative services.

- In 2003-04, total operating expenses increased $6.3 million, or 7 percent, compared to 2002-03 activity. Significant expense variances are noted below.
  - Collection agency fees decreased $4.6 million as a result of decreased collection recoveries from the prior year.
  - Computer expense increased almost 19 percent due to computer maintenance and repairs.
  - Program grants and awards increased to almost $13 million, up $10.5 million from prior year, primarily due to a new student outreach program. The Outreach program, established in 2003-04, provides student outreach over a three-year plan. The program goals are to increase awareness of the Cal Grant entitlement program and to increase student awareness towards success in postsecondary education.

EDFUND

Balance Sheets

September 30, 2005 and 2004

Assets		2005	2004
Current assets:			
Cash and cash equivalents (note 3)	$	53,713,454	44,129,233
Due from Operating Fund (note 4)		11,153,701	20,200,625
Prepaids and other assets		1,154,165	1,634,818
Total current assets		66,021,320	65,964,676
Capital assets, net of accumulated depreciation (note 5)		4,231,105	2,553,390
Total assets	$	70,252,425	68,518,066
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	$	649,914	598,927
Due to Federal Fund (note 4)		5,850,524	4,270,321
Accrued payroll		5,035,066	4,615,612
Accrued expenses and other liabilities		7,733,755	9,494,228
Advance payable to the Commission (note 2)		20,000,000	20,000,000
Total current liabilities		39,269,259	38,979,088
Long-term liabilities (note 7)		3,500,972	2,672,877
Total liabilities		42,770,231	41,651,965
Commitments and contingencies (note 6)			
Net assets:			
Invested in capital assets		4,231,105	2,553,390
Unrestricted		23,251,089	24,312,711
Total net assets		27,482,194	26,866,101
Total liabilities and net assets	$	70,252,425	68,518,066

See accompanying notes to basic financial statements.

EDFUND

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 2005 and 2004

	2005	2004
Operating revenues:		
Program service fees	$ 96,549,469	95,415,357
Total operating revenues	96,549,469	95,415,357
Operating expenses:		
Salaries and benefits	53,513,604	50,632,118
Program grants and awards	6,089,300	12,906,953
Collection agency fees	9,705,719	7,954,069
Consulting and professional fees	9,022,815	6,960,450
Facilities operations and rental expense	3,875,882	3,711,782
Computer expense	3,296,166	3,346,357
Travel expenses	2,511,462	1,940,523
Depreciation expense	1,411,760	1,726,162
Printing expenses	1,523,258	1,508,640
Other operating expenses	5,599,503	4,728,303
Total operating expenses	96,549,469	95,415,357
Operating income	—	—
Nonoperating revenues (expenses):		
Grant administrative service fees	669,583	602,497
Interest income, net (note 3)	616,093	233,781
Grant administrative costs	(669,583)	(602,497)
Total nonoperating revenues	616,093	233,781
Change in net assets	616,093	233,781
Net assets, beginning of year	26,866,101	26,632,320
Net assets, end of year	$ 27,482,194	26,866,101

See accompanying notes to basic financial statements.

EDFUND

Statements of Cash Flows

Years ended September 30, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Cash received from customers	$ 105,644,091	83,255,753
Cash paid to suppliers and vendors	(55,736,384)	(52,817,219)
Cash paid to employees for services	(40,121,592)	(38,646,784)
Net cash provided by (used in) operating activities	9,786,115	(8,208,250)
Cash flows from noncapital financial activities:		
Purchase of defaulted loans	(514,827,130)	(381,174,478)
Reimbursements from the Commission of defaulted loans	514,827,130	381,174,478
Receipts from ED	524,127,987	433,735,879
Reimbursements to the Commission of amounts received from ED	(522,972,140)	(434,888,022)
Cash receipts from repurchased loans	11,030,191	11,836,603
Cash remitted to the Commission for repurchased loans	(11,030,191)	(11,836,603)
Cash receipts from collections	115,018,651	103,448,984
Cash remitted to the Commission for collections	(113,903,010)	(104,013,004)
Net cash provided by (used in) noncapital financing activities	2,271,488	(1,716,163)
Cash flows used in capital and related financing activities:		
Purchases of capital assets	(3,089,475)	(1,316,064)
Cash flows from investing activities:		
Interest received	1,270,943	408,020
Remittances to the Commission of interest received	(654,850)	(174,239)
Net cash provided by investing activities	616,093	233,781
Net increase (decrease) in cash and cash equivalents	9,584,221	(11,006,696)
Cash and cash equivalents, beginning of year	44,129,233	55,135,929
Cash and cash equivalents, end of year	$ 53,713,454	44,129,233
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Operating income	$ —	—
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
Depreciation expense	1,411,760	1,726,162
Loss on disposition of capital assets	—	2,447
Change in assets and liabilities:		
Due from the Commission	8,355,639	(12,159,604)
Prepaids and other assets	480,653	(75,287)
Accounts payable	50,987	(538,080)
Accrued payroll	419,454	168,277
Accrued expenses and other liabilities	(1,760,473)	2,007,245
Long-term liabilities	828,095	660,590
Net cash provided by (used in) operating activities	$ 9,786,115	(8,208,250)

See accompanying notes to basic financial statements.

(1) Organization and Operations

EDFUND, a nonprofit public benefit corporation, was created on January 2, 1997, as an auxiliary organization of the California Student Aid Commission (Commission) pursuant to Section 69522(a) of the California Education Code. Additionally, EDFUND is a component unit of the Commission.

EDFUND was created to administer, operate, and provide services essential to the Commission's participation in the Federal Family Education Loan (FFEL) Program. Most of the expenses incurred for administering the FFEL Program are recorded in EDFUND's financial records while other expenses incurred for administering the FFEL Program are recorded in financial statements of the Commission. In order to fully understand the nature of and the expenses associated with administering the FFEL Program, the EDFUND financial statements should be read in conjunction with the financial statements of the Commission's Federal Student Loan Reserve Fund and Student Loan Operating Fund as of June 30, 2004 and for the year then ended.

EDFUND operates under the terms and conditions set forth in an annual operating agreement between the Commission and EDFUND. The operating agreement is renewed or extended annually on October 1. Under the agreement, EDFUND is reimbursed for all expenses incurred on behalf of the Commission in administering the FFEL Program.

In the event that the annual operating agreement should terminate and in the absence of a subsequent agreement, EDFUND's assets become the property of the Commission.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accounts of EDFUND are maintained in accordance with the principles of fund accounting. Fund accounting is a system under which resources are classified for accounting and reporting purposes into funds established according to their purpose.

EDFUND is a proprietary component unit of the Commission. Proprietary component units use the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the timing of the related cash flow. The financial statements of EDFUND have been prepared in accordance with generally accepted accounting principles, including all applicable statements of the Governmental Accounting Standards Board (GASB), and all statements of the Financial Accounting Standards Board through November 30, 1989.

(b) Tax-Exempt Status

EDFUND qualifies as a tax-exempt organization under Section 501(c)(3) of the U.S. Internal Revenue Code and corresponding provisions of California law and, accordingly, is not subject to federal or state income taxes.

(c) Capital Assets

Capital assets are stated at cost and depreciated using the straight-line method over their estimated useful lives of three to five years (term of lease as to leasehold improvements).

(d) Revenue Recognition

Program service fee revenue represents an amount equal to the expenses incurred by EDFUND in assisting the Commission in administering the FFEL Program. Program service fee revenue is recognized when the related expense is incurred.

Operating revenues and expenses result from exchange transactions associated with the principal activities of EDFUND. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues and expenses, such as investment earnings and grant administrative service fees and costs, result from nonexchange transactions and/or revenues and expenses not earned nor incurred in administering the FFEL Program.

(e) Salaries

EDFUND has two types of employees: employees directly hired by EDFUND and civil service employees of the Commission who have been assigned to work for EDFUND (Assigned Employees). Salary expense includes the salaries, wages, and related benefits of both EDFUND employees and the Assigned Employees. The salaries, wages, and related benefits of the Assigned Employees are paid by the Commission and EDFUND reimburses the Commission for those amounts.

(f) Related Party Transactions

On January 2, 1997 the Commission advanced $20,000,000 to EDFUND for operating capital. The terms of the advance have not been clearly defined, and therefore currently determined to be due on demand. As of September 30, 2005 no payments were required. Interest income earned on the unused portion of the advance is reimbursed to the Commission.

As described more fully in note 1, the majority of EDFUND's revenues are earned under the operating agreement with the Commission. EDFUND is contingently liable on an operating lease provided for the benefit of the Commission (note 6).

As described more fully in note 4, all expenses incurred as a function of performing FFEL services for the Commission or any amounts paid on behalf of the Commission by EDFUND, are fully reimbursable from the Commission.

(g) Concentrations of Credit Risks

Financial instruments that potentially subject EDFUND to concentrations of credit risk consist primarily of cash and cash equivalents related to money market deposit accounts. EDFUND maintains its cash in bank deposits with one financial institution. It maintains cash equivalents of $26,344,605, at September 30, 2005, in money market accounts. The money market balances are generally not insured or guaranteed (note 3).

(h) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

(i) New Accounting Pronouncement

For the fiscal year ended September 30, 2005, EDFUND implemented GASB Statement No. 40, *Deposits and Investment Risk Disclosures – an Amendment of GASB Statement No. 3.* This statement addresses common deposits and investment risks related to credit risks, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement also are required to be disclosed. Implementation of GASB Statement No. 40 did not have an impact on EDFUND ‘s financial statements as of and for the year ended September 30, 2005 but required additional disclosures related to deposits and investment risks (note 3).

(3) Cash and Cash Equivalents

At September 30, 2005, EDFUND maintains cash equivalents of $58,891,283 invested in a mutual fund in the amount of $32,546,678 and money market deposit accounts in the amount of $26,344,605. Interest earned on cash equivalents is allocated between EDFUND and the Commission. Interest earned on unused monies of the operating advance is due to the Commission and EDFUND retains the remaining interest earned.

At September 30, 2005 and 2004, the carrying value of the cash and cash equivalents approximated its market value because of its short-term maturity (weighted average maturity is under 90 days). Interest earned for the year ended September 30, 2005 totaled $1,270,943 of which $654,850 was allocated to the Commission. Interest earned for the year ended September 30, 2004 totaled $408,020 of which $174,239 was allocated to the Commission.

Custodial credit risk is the risk that in the event of a bank failure, EDFUND’s deposits may not be returned. EDFUND does not have a deposit policy for custodial credit risk. As of September 30, 2005, $26,244,605 of EDFUND’s money market balance of $26,344,605 was exposed to custodial credit risk as $26,244,605 was not insured or collateralized.

EDFUND does not have a formal investment policy that limits investment maturities as a means of managing exposure to fair value losses arising from increasing interest rates. As of September 30, 2005, EFDUND’s investment in the Columbia Money Market Reserve mutual fund was rated Aaa by Moody’s Investor Services and AAAm by Standard & Poor’s.

(4) Due from the Commission

All expenses incurred as a function of performing FFEL services for the Commission or any amounts paid on behalf of the Commission by EDFUND, are fully reimbursable from the Commission. Conversely, all monies received by EDFUND on behalf of the Commission, such as reinsurance from the United States Department of Education (ED) on defaulted loan purchases or recoveries on defaulted loans, are due to the Commission.

The net amount due from the Commission at September 30, is comprised of the following:

		2005	2004
Amounts due from the Commission:			
Due from Operating Fund	$	11,153,701	20,200,625
Amounts due to the Commission:			
Due to Federal Fund		(5,850,524)	(4,270,321)
Due from the Commission	$	5,303,177	15,930,304

(5) Capital Assets

Capital asset activity for the year ended September 30, 2005 is as follows:

		Beginning balance	Additions	Disposals	Ending balance
Vehicles	$	58,186	—	—	58,186
Computer equipment		3,364,373	981,074	—	4,345,447
Computer software		2,877,248	605,407	—	3,482,655
Equipment, furniture, and fixtures		726,068	—	—	726,068
Leasehold improvements		236,369	98,978	—	335,347
Construction in progress		—	1,404,016	—	1,404,016
		7,262,244	3,089,475	—	10,351,719
Less accumulated depreciation:					
Vehicles		(17,539)	(11,637)	—	(29,176)
Computer equipment		(2,214,326)	(711,204)	—	(2,925,530)
Computer software		(2,069,830)	(486,970)	—	(2,556,800)
Equipment, furniture, and fixtures		(319,468)	(144,037)	—	(463,505)
Leasehold improvements		(87,691)	(57,912)	—	(145,603)
		(4,708,854)	(1,411,760)	—	(6,120,614)
Capital assets, net	$	2,553,390	1,677,715	—	4,231,105

Capital asset activity for the year ended September 30, 2004 is as follows:

	Beginning balance	Additions	Disposals	Ending balance
Vehicles	$ 58,186	—	—	58,186
Computer equipment	2,986,346	411,659	(33,632)	3,364,373
Computer software	2,196,612	680,636	—	2,877,248
Equipment, furniture, and fixtures	514,834	214,796	(3,562)	726,068
Leasehold improvements	227,396	8,973	—	236,369
	5,983,374	1,316,064	(37,194)	7,262,244
Less accumulated depreciation:				
Vehicles	(6,102)	(11,437)	—	(17,539)
Computer equipment	(1,369,774)	(877,161)	32,609	(2,214,326)
Computer software	(1,406,038)	(663,792)	—	(2,069,830)
Equipment, furniture, and fixtures	(199,346)	(122,260)	2,138	(319,468)
Leasehold improvements	(36,179)	(51,512)	—	(87,691)
	(3,017,439)	(1,726,162)	34,747	(4,708,854)
Capital assets, net	$ 2,965,935	(410,098)	(2,447)	2,553,390

(6) Commitments and Contingencies

Operating Leases

EDFUND maintains various operating leases for its main and regional offices. Rental expense for the years ended September 30, 2005 and 2004 was $3,094,488 and $2,979,368, respectively. Future minimum rental payments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of September 30, 2005, are as follows:

	Gross obligation per lease agreements	Commission sublease amount	Net obligation
Fiscal year ending September 30:			
2006	$ 3,497,506	(153,574)	3,343,932
2007	3,425,335	(157,029)	3,268,306
2008	904,213	(160,563)	743,650
Thereafter	300,515	(95,263)	205,252
	$ 8,127,569	(566,429)	7,561,140

In May 2001, EDFUND entered into a noncancelable operating lease for the Commission's office facility that expires in 2008. The annual minimum rental payments are included in the schedule above. The Commission reimburses EDFUND for all costs associated with the lease agreement.

The noncancelable operating lease for EDFUND's main offices expires in 2007 and provides for a five-year renewal option. In the event of default by EDFUND or the termination of the operating agreement between the Commission and EDFUND, the leases will be assumed by the Commission for the remainder of the lease terms.

(7) Retirement Benefits

(a) EDFUND Employees

Effective July 1, 1997, EDFUND established a defined contribution retirement savings plan (Plan), comprised of the EDFUND Employees' Retirement Plan 403(b) and the EDFUND Employer Contribution Plan 401(a) for those employees hired by EDFUND. Effective January 1, 2003 EDFUND established the new EDFUND 401(k) Plan. The 403(b) plan became a "frozen" plan and employee voluntary contributions beginning January 1, 2003 were made into the new 401(k) plan. The 401(a) plan converted to the new EDFUND 401(K) plan. EDFUND makes a non-elective contribution for each EDFUND employee. In addition, all regular full-time and part-time employees over the age of 18 and working more than 20 hours per week may contribute on a pre-tax basis from 1 percent to 90 percent of their annual compensation up to the Internal Revenue Service limits. EDFUND contributes a percentage match of 100 percent of employee contributions up to 4 percent of salary.

The Plan is administered by Fidelity Investments. Amendments to the Plan are subject to approval and ratification by EDFUND's board of directors.

Total covered payroll for the EDFUND employees was $40,667,826 and $39,266,222 for the years ended September 30, 2005 and 2004, respectively. Total employer contributions and employee contributions were $2,870,704 and $2,736,136, respectively, for the year ended September 30, 2005, and $2,460,102 and $2,461,919, respectively, for the year ended September 30, 2004.

In addition to defined contribution plan benefits, EDFUND also provides postretirement benefits through the EDFUND Postretirement Medical and Life Plan. The Plan provides for medical, dental, vision and life insurance benefits to employees based on age upon retirement and length of service. The postretirement healthcare benefits are funded on a pay-as-you-go basis and the related expenses and liabilities are calculated using actuarial-based accrual method. EDFUND uses a September 30 measurement date and assumed that the annual discount rate is 5.75 percent and 6 percent at the end of the measurement periods September 30, 2005 and 2004, respectively. EDFUND recognized expense of $655,067 and $510,548 for the years ended September 30, 2005 and 2004, respectively. At September 30, 2005, there were seven retirees eligible to receive benefits. At September 30, 2004, there were five retirees eligible to receive benefits. Included in long-term liabilities is the EDFUND

Postretirement Medical and Life Plan of $3,046,631 and $2,391,590 for the years ended September 30, 2005 and 2004, respectively. These determinations were computed in accordance with Statement of Financial Accounting Standards No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*.

(b) Assigned Employees

All assigned employees are eligible to participate in the California Public Employees' Retirement System (PERS). PERS, a multiple-employer defined benefit retirement plan, is administered by a Board of Administration composed of individuals (1) elected by PERS membership; (2) appointed by elected state of California officials; and (3) elected state of California officials. PERS provides retirement, disability, and death benefits. Such benefits are based on the employee's years of service, age, and final compensation. PERS issues a publicly available financial report that includes financial statements and required supplementary information, which may be obtained by writing to California Public Employees' Retirement System, 400 P Street, Sacramento, CA 94229-2701.

Assigned employees may participate in PERS at one of three levels; first-tier participants contribute a portion of their salaries to a retirement fund, second-tier employees do not make contributions and Alternate Retirement Program (ARP) participants contribute to a special retirement account for the first two years of State service. The ARP was established for State of California employees hired on or after August 11, 2004. All new State civil service employees are automatically enrolled in ARP for the first two years of employment with the State. After two years, employees will have the option of choosing between the first-tier and second-tier. See the Department of Personnel Administration's website (www.dpa.ca.gov) for additional information. In addition to the employee's contributions to PERS, the State also contributes into PERS towards civil service retirement benefits. The State's contribution varies annually based on the Budget Act. First-tier employees vest after five years of service and may receive retirement benefits at age 50. Second-tier employees vest after ten years of service and may receive retirement benefits at age 55. As of September 30, 2005 and 2004, there were 57 and 62 employees classified as first tier, respectively, 5 and 7 employees classified as second tier, respectively and no employees participating in the ARP, supporting direct FFEL Program activities. State records relating to pension benefit obligations and net assets available for benefits are not separately available for EDFUND.

Total PERS expense and funded contributions for the Assigned Employees was $595,907 and $545,874 for the years ended September 30, 2005 and 2004, respectively. All contributions were paid as of September 30, 2005.

(8) Deferred Compensation

EDFUND offers certain employees a deferred compensation plan "rabbi trust" created in accordance with Internal Revenue Code Section 457. The plan, available to select employees permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All amounts of compensation deferred under the plan are set aside for participants and their beneficiaries and are included in the financial statements as cash and cash equivalents, and long term liabilities.